Economic Outlook

B4750-2

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research &
Planning Division

May 1985

Recent monthly reports indicate that important sectors of the economy remain sluggish. Nevertheless, it is likely that real economic growth in the second quarter will show considerable improvement compared to the first quarter's weak performance. Real GNP is expected to rise 3.5% this year from the 1984 level, versus an increase of 6.8% last year from the 1983 level.

Despite continuing signs of softness, there are also indications that the economy is poised for a rebound in growth. The slowdown began when real GNP rose at only a 1.6% annual rate during the third quarter of 1984. The net contribution of consumer spending toward this increase was a paltry 0.4%. The subsequent net contributions of personal consumption expenditures to real GNP growth were 2.3% in the fourth quarter and 3.0% in the first quarter. The comparable net contribution in the current quarter is expected to be about 2.6%, hardly a buoyant increase but nevertheless strong enough to help get overall growth back on track again.

Retailers and manufacturers were caught off guard by the weakness of consumer spending last summer and had to contend with a substantial buildup of inventories. During the past few quarters, firms have tried to restrain growth in inventories, while consumers have spent at an improved rate. Recently released data indicate that the rise in inventories in the first quarter was substantially smaller than shown in earlier estimates. Despite its negative connotations for the first quarter's real GNP growth, this is a favorable sign that the mini-inventory cycle the economy has been experiencing is nearing completion.

Despite the slowdown, the growth of the economy since the end of the last recession has been quite normal compared to earlier recoveries. The increases in both real GNP and industrial production from the recession trough levels are now remarkably close to the average increases in prior recoveries. Moreover, the decline in the unemployment rate from its recession peak is one of the sharpest on record. Upon hearing such information, some businessmen have responded: If this is supposed to be such a good recovery, then why does it feel so bad? Herein, we have a major irony of this recovery.

Many of the broad statistics still portray a generally favorable pattern for this recovery, even with the slowdown. At the same time, numerous firms have had major disappointments in earnings, while a few firms and industries have simply watched the recovery pass by without being able to join the parade. Losses during a business expansion are not unusual, but the extent and magnitude of the continued losses during the past few years are extraordinary.

Performance has been lopsided among industries, with some industries registering strong gains while others have had losses or weak results compared to prior experience. After-tax profits this year are expected to rise about 2.3% from last year's level, compared to a 14.5% rise in earnings in 1984 and a 21.6% rise in 1983. For many firms, the various effects of a strong dollar--primarily the loss of market share both at home and abroad as a result of strong competition from low-cost foreign producers--will remain the most serious obstacle to improved earnings performance.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual	1985			Forecast 1986				Actual	Forecast	
	I	II	III	IV	I	II	III	IV	1983-1984	1984-1985	1985-1986
Gross National Product	6.7	8.0	9.3	8.9	9.1	6.5	7.3	8.6	10.8	7.6	8.3
Real GNP	1.3	4.5	4.8	4.1	4.0	1.4	2.0	3.0	6.8	3.5	3.3
GNP Price Deflator	5.3	3.4	4.3	4.6	4.9	5.0	5.2	5.5	3.8	4.0	4.8

	Actual 1985: I	Forecast 1985:II	Actual 1983-1984	Forecast 1984-1985	Forecast 1985-1986
Consumer Spending	8.0%	7.5%	8.6%	7.4%	8.4%
Durable Goods	8.6	14.6	13.9	9.1	8.8
Nondurable Goods	5.4	6.2	6.9	5.1	7.7
Services	9.6	6.6	8.5	8.7	8.8
Business Capital Spending	7.5	10.9	20.6	11.4	8.3
Structures	17.6	16.5	16.0	15.6	9.8
Equipment	2.3	7.7	23.4	9.1	7.4
Residential Investment	3.9	22.0	16.4	6.6	6.3
			1984	1985	1986
Change in Inventories	$46.6b.	$50.0b.	$58.2b.	$54.2b.	$63.3b.
Net Exports of Goods and Services	$-73.0b.	$-88.0b.	$-64.2b.	$-91.4b.	$-107.5b.
			1983-1984	1984-1985	1985-1986
Government Purchases	6.4%	11.2%	9.0%	10.2%	8.6%
Federal	5.8	14.7	9.5	13.7	8.1
Defense	5.0	17.5	10.5	11.8	9.0
Other	7.9	7.5	6.7	19.2	5.8
State & Local	6.7	8.8	8.7	8.0	8.9
Corporate Profits Before Tax	-6.4*F	-3.4	16.0	2.7	5.7
Corporate Profits After Tax	-6.8*F	-2.5	14.5	2.3	5.8
Plant and Equipment Expenditures	14.7	9.6	16.0	8.7	7.1
Real Final Sales#	0.4	4.1	5.0	3.6	3.3
Real Disposable Personal Income	-1.8	4.6	6.7	3.8	3.1

Economic Indicators	Recent Data Feb.	Mar.	Apr.	Actual 1983-1984	Forecast 1984-1985	1985-1986
Consumer Price Index**	3.6%	6.0%	n.a.	4.0%	4.3%	5.0%
Producer Price Index for Finished Goods**	-1.2	2.4	3.6	1.7	3.1	5.0
Industrial Production	1.2	3.6	-2.4	10.6	3.2	4.0
Retail Sales##	1.0	-0.7	0.9	10.5	6.8	6.8
				1984	1985	1986
Auto Sales (millions of units, a.r.)	11.0	10.7	11.1	10.4	10.8	10.2
Housing Starts (millions of units, a.r.)	1.65	1.88	1.91	1.75	1.77	1.65
Unemployment Rate	7.3%	7.3%	7.3%	7.5%	7.0%	6.8%
Merchandise Trade Deficit (a.r.)	$137.3b.	$132.6b.	n.a.	$123.3b.	$148.0b.	$160.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).
$b. = billions a.r. = annual rate F = Forecast

May 17, 1985